Donna Jamison was brought in as assistant to Fred Campo, Computron’s chairman, who had the task of getting the company back into a sound financial position.

Computron’s 2009 and 2010 balance sheets and income statements, together with projections for 2011, are shown in the tables. The 2009 and 2010 financial ratios are also shown along with industry average data. The 2011 projected financial statement data represent Jamison’s and Campo’s best guess for 2011 results.

Balance Sheets 2009, 2010, 2011

Assets

Cash $9,000, $7,282, $14,000

Short-term investments $48,600, $20,000, $71,632

Accounts receivable $351,200, $632,160, $878,000

Inventories $715,200, $1,287,360, $1,716,480

Total current assets $1,124,000, $1,946,802, $2,680,112

Gross fixed assets $491,000, $1,202,950, $1,220,000

Less: Accumulated depreciation $146,200, $263,160, $383,160

Net fixed assets $344,800, $939,790, $836,840

Total assets $1,468,800, $2,886,592, $3,516,952

Liabilities & Equity

Accounts payable $145,600, $324,000, $359,800

Notes payable $200,000, $720,000, $300,000

Accruals $136,000, $284,960, $380,000

Total current liabilities $481,600, $1,328,960, $1,039,800

Long-term debt $323,432, $1,000,000, $500,000

Common stock (100,000 shares) 460,000, 460,000, 1,680,936

Retained earnings $203,768, $97,632, $296,216

Total equity $663,768, 557,632, $1,977,152

Total liabilities & equity $1,468,800, $2,886,592, $3,516,952

Income statements

 Sales $3,432,000, $5,834,400, $7,035,600

Cost of goods sold $2,864,000, $4,980,000, $5,800,000

Other expenses $340,000, $720,000, $612,960

Depreciation $18,900, 116,960, 120,000

Total operating costs $3,222,900, 5,816,960, 6,532,960

EBIT $209,100, 17,440, 502,640

Interest expense $62,500, 176,000, 80,000

EBT $146,600, (158,560), 422,640

Taxes (40%) $58,640, (63,424), 169,056

Net income $87,960, (95,136), 253,584

Other data

Stock price $8.50, 6.00, 12.17

Shares outstanding 100,000, 100,000, 250,000

EPS $0.880, (0.951), 1.014

DPS $0.220, 0.110, 0.220

Tax rate 40%, 40%, 40%

Book value per share $6.638, $5.576, 7.909

Lease payments $40,000, 40,000, 40,000

Ratio Analysis 2009 2010 2011 Industry Average

Current 2.3 1.5 2.7

Quick 0.8 0.5 1.0

Inventory turnover 4.8 4.5 6.1

Days sales outstanding 37.3 39.6 32.0

Fixed assets turnover 10.0 6.2 7.0

Total assets turnover 2.3 2.0 2.5

Debt ratio 54.8% 80.7% 50.0%

TIE 3.3 0.1 6.2

EBITDA coverage 2.6 0.8 8.0

Profit margin 2.6% -1.6% 3.6%

Basic earning power 14.2% 0.6% 17.8%

ROA 6.0% -3.3% 9.0%

ROE 13.3% -17.1% 17.9%

Price/Earnings (P/E) 9.7 -6.3 16.2

Price/Cash flow 8.0 27.5 7.6

Market/Book 1.3 1.1 2.9

a. Why are ratios useful? What three groups use ratio analysis and for what reasons?

b. Calculate the 2011 current and quick ratios based on the projected balance sheet and income statement data. What can you say about the company’s liquidity position in 2009, 2010, and as projected for 2011? We often think of ratios as being useful (1) to managers to help run the business, (2) to bankers for credit analysis, and (3) to stockholders for stock valuation. Would these different types of analysts have an equal interest in the liquidity ratios?

c. Calculate the 2011 inventory turnover, days sales outstanding, fixed assets turnover, and total assets turnover. How does Computron’s utilization of assets stack up against that of other firms in its industry?

d. Calculate the 2011 debt, times-interest-earned, and EBITDA coverage ratios. How does Computron compare with the industry with respect to financial leverage? What can you conclude from these ratios?

e. Calculate the 2011 profit margin, basic earning power (BEP), return on assets (ROA), and return on equity (ROE). What can you say about these ratios?

f. Calculate the 2011 price/earnings ratio, price/cash flow ratio, and market/book ratio. Do these ratios indicate that investors are expected to have a high or low opinion of the company?

g. Perform a common size analysis and percentage change analysis. What do these analyses tell you about Computron?

h. Use the extended Du Pont equation to provide a summary and overview of Computron’s financial condition as projected for 2011. What are the firms’s major strengths and weaknesses?